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ABSTRACT

In this address, the president of the World Bank and the International Finance Corporation indicates that all countries, industrial and developing, have a stake in an open international trading system. The experience of the World Bank in working closely with its developing member countries has demonstrated that healthy and sustained economic growth goes hand in hand with a rapid expansion of exports. The export prospects of developing countries depend on internal domestic policies and on external conditions such as the growth rate of the GNP in the industrial countries and the degree to which their markets are open to the developing countries' products. The developed and developing nations are economically interdependent. For example, industrial nations constitute almost two-thirds of the world market for Third World exports; developing countries take 40 percent of all U.S. exports. The World Bank plays a vital role in the trade field by providing information and analyses on the links between trade and development, by promoting the greater integration of Third World countries into the international trading system, and by supporting efforts which foster an open-trading system. (RM)

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INTERNATIONAL TRADE AND GLOBAL ECONOMIC GROWTH: THE CRITICAL RELATIONSHIP

Address

As Prepared for Delivery

By

A. W. Clausen, President

The World Bank

and

International Finance Corporation

before the

Detroit Economic Club

Detroit

May 23, 1984

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Mr. Mecke,
Ladies and Gentlemen:

It is an honor for me to be invited to address the Detroit Economic Club as the final speaker in your Jubilee Year program.

This seems to be both an appropriate time and place to share some thoughts on international trade and the vital role it must play in securing a healthy global economy. Whether we live in Detroit or Dakar, Milan or Manila, our present and future economic well-being cannot but be profoundly affected by the prevailing international trading environment.

All countries, industrial and developing, have a stake in an open international trading system. It is a system that has served the world well since the end of the Second World War. Post-war trade expansion, facilitated by the reduction in trade barriers -- in which the United States led the way -- clearly benefited both developed and developing countries. Trade liberalization was a powerful stimulus to Western Europe's economic recovery and growth, and through trade the stimulus to growth was transmitted to the developing countries. In turn, the developing countries have become increasingly important as markets for the exports of industrial countries, as this country has discovered to its great benefit.

But the open multilateral trading system, which has served us so well, is being seriously eroded. That is our pressing concern as we emerge from the long and damaging recession.

The heads of government of the seven major industrial democracies will be meeting at the London summit in just two weeks time. A year ago, at the Williamsburg summit, the need for trade liberalization was fully and explicitly recognized. But that recognition has not been acted upon.

This must not happen again. The major economic powers will be meeting in London at a time when recovery from the recession is gaining in strength. Conditions are therefore more conducive to firm action now, and without delay.

It needs to be more widely understood here in the United States that this country's own long-term economic interests, its prospects for increased productivity and growth, are best served by open trading. And it should also be understood that to put one's faith in restrictive trade measures as a quick cure for unemployment problems is to pursue mere illusions.

In times of recession, these truths can all too easily fall victim to expediency. But economic recovery is now underway in this country, as it is, though at a slower pace, in most of the rest of the industrial world.

The arrival of economic recovery here in the United States is as welcome to Detroit as the coming of the rain to a drought-stricken farmer. Some areas of the globe suffered more than others from the recession. And within the United States, Detroit suffered more than most. The impact of the economic slowdown on this dynamic community was painful indeed, imposing great hardship, and striking at the very fabric of human society here.

But, as we greet the upturn in the economy here with understandable relief, we have to face the fact that many developing countries still confront acute economic problems. In some of them, growth in per capita income has slowed down dramatically, needed investments are being postponed, and efforts to reduce poverty have been interrupted. And the creditworthiness of a number of countries has been seriously weakened. The prospects of the Third World have been badly damaged, and it will take years to repair that damage.

The recession has shown us more clearly than ever before just how economically interdependent the nations of the world have become. What economic policies the developing countries adopt; what reforms they implement; how effectively they adjust to the changed global economic environment: these will be decisive factors governing their climb back to healthy growth rates. But the industrial countries' choice of economic policies will also have profound implications for the developing countries.

Let me call your attention, then, to two problems right here in the United States which are linked, and which have significant implications for the Third World. They are problems which are familiar to all of us, and are, or should be, of serious concern to policy makers both here and abroad. The first is the current account deficit; the second is this country's unprecedented peacetime budget deficit.

In 1984 the current account deficit is expected to reach at least $60 billion. The bare fact of the matter is that the U.S. is today investing more than the amount that can be financed from domestic savings, and the difference is being made up by net inflows of resources from abroad -- that is, by the balance-of-payments deficit on current account.

The main reason why there is a shortage of domestic savings in this country is no secret. It is the huge budgetary deficit of the Federal government that sops up savings and crowds out private investment. The result of this competition for scarce domestic savings is high interest rates that attract foreign capital, which in turn finances the excess of imports of goods and services over exports of goods and services.

The high interest rates also serve to strengthen the foreign exchange value of the dollar, thereby discouraging U.S. exports and encouraging imports. In short, there is a close relationship between the budget deficit, high interest rates, a strong dollar, and the current account deficit.

And what are the implications of this for the developing countries? The immediate effect of high interest rates is to increase the already enormous debt service burden of the developing countries. On their accumulated external liabilities of some $800 billion, a one percentage point increase in interest rates adds roughly $4 billion to this burden.

A second implication is that large U.S. trade and current account deficits tend to fuel protectionist pressures. Domestic industries who feel they are adversely affected by foreign competition are increasingly petitioning the government for relief by imposing restrictions on imports including imports from developing countries. Yet for some years to come the only way that developing countries will be able to cover payments on their accumulated debt will be by generating an excess of exports over imports.

In the last year or so the major debtors among the developing countries have in fact succeeded in achieving trade surpluses. But this was accomplished mainly by dramatically compressing imports rather than by expanding exports. Imports were cut in real terms by about half in Argentina in 1982, by about 40 percent in Mexico the same year. They were cut by 30 percent between 1980 and 1983 in Brazil. This import compression reflects austerity measures that not only slow down growth in the developing countries, but, by reducing the industrial countries' exports, hurt them as well. And that very much includes the United States. The United States lost about $21 billion in net exports to Latin America between 1981 and 1983. According to a rule of thumb which the U.S. government has used, that translates into some 500,000 Americans unemployed. What is needed, then, is expanding exports by the developing countries to finance <u>both</u> increasing imports <u>and</u> the servicing of their external debt.

Resort by the United States to protectionist measures would not only intensify the financial problems with which the developing nations are struggling; it would also be an ineffective response to this country's own current-account deficit. Trade restrictions favor some domestic industries at the expense of others. They alter the pattern of domestic expenditure, but they have little impact on total spending. Because the U.S. current account deficit represents an excess of domestic spending over the amount produced, trade restrictions cannot have more than a transitory effect on the size of the deficit. The adjustment of the deficit needs to be addressed through macroeconomic measures.

Detroit is one place where the importance of international trade needs no demonstration. Import competition has certainly created problems for the U.S. auto industry. I believe we would all agree, however, that it has at the same time served as a potent catalyst for the industry's remarkable recent performance in innovating technologically, improving quality and raising productivity. The industry is becoming increasingly integrated into world markets, through the sourcing of components of foreign countries in response to comparative costs and world-wide production possibilities.

Having noted that trade restrictions favor some domestic industries at the expense of others, I feel bound to add that the consumers of the products of those protected industries may feel anything but favored. There were many forecasts that restraints on automobile imports would place a heavy burden on car purchasers. You who are representatives of the automobile industry may well have more accurate figures than I on increases in price due to import restraints. But two studies that I have seen suggest that price increases range from $500 to $1,900 per automobile. No matter whose figures are better, reduced competition has increased prices -- the certain consequence of protectionism.

Similarly, the so-called "self-restraint" being exercised by major foreign steel exporters means that American users of steel are paying much higher prices for steel here than their counterparts abroad. The cost to the United States' users of steel of trigger prices, quotas and orderly marketing arrangements was estimated at about $7 1/4 billion for 1978. And that was before more stringent restraints were introduced in 1983.

Both the auto and steel industries must adjust to changing world trade conditions. To continue to protect these industries can only ensure their longer-term decline in competitiveness. Furthermore, while jobs in particular industries can be protected by restrictive trade measures, the certain consequence is that the total number of jobs in all the nation's industries must fall.

Official voices recently raised against the false sense of security that protectionism creates give hope that further protectionist pressures may be resisted. It is vital that they should be. I must add that voices should also be raised in other industrial countries, for I do not wish to give the impression that I see the United States as the principal or sole offender. That is far from the case, as will be noted in the course of my remarks.

* * * *

I have suggested why it is essential that protectionist measures be avoided if debt-servicing by the developing countries is to occur in a regular manner. But the case for an open world trading system transcends the existing financial plight of the developing world.

The experience of The World Bank in working closely with its developing member countries has demonstrated that healthy and sustained economic growth tends to go hand in hand with a rapid expansion of exports. Moreover, one of the differences that weighed heavily in the recent recession was that between inward- and outward-looking trade policies. The benefits of the latter are felt in terms of higher growth rates in the long run and in a greater ability to adjust to external shocks. There is convincing evidence that outward-oriented countries such as the middle-income countries of East Asia have weathered the storm of the recession relatively well, and have shown a generally superior growth performance.

Expanding trade contributes to growth in many ways. It enables countries to improve their productivity by specializing in those products in which their comparative advantage is greatest. And by producing for the world market rather than for their limited domestic markets, developing countries can garner the economies of scale that are so important in modern industry. Efficiency is also encouraged by competition from imports made possible by expanded earnings from exports.

In addition, expanding trade inevitably exposes a country to new products, new technology, new ideas and new standards. The result is a stimulus to learning, innovation, entrepreneurship and investment. The case for an open world trading system, therefore, is not only the static gains from the more efficient use of a country's <u>existing</u> resources but also the dynamic gains from the opportunities to <u>expand</u> resources through new investment, increased knowledge and improved skills.

Since the end of the Second World War, the trade of the developing countries has undergone a profound evolution. Before the war, trade between rich and poor countries tended to consist basically of an exchange of the primary materials of the developing countries for the manufactured products of the developed countries. This pattern began to change after the war as a number of developing countries sought to industrialize. And they did so with protection that encouraged the substitution of domestic production for imports of manufactured products.

Most of these so-called "import substitution" strategies provided high protection to some industries, but with adverse consequences for exports and economic growth. A number of developing countries, therefore, began to shift in the 1960s toward more outward-looking policies by reducing the bias in their incentive systems that favored production for the home market over manufacturing for export. Typically this involved less reliance on quantitative import restrictions, lower and more uniform tariffs, and, most importantly, more realistic exchange rates.

This strategy shift was facilitated in the 1960s and early 1970s by a favorable world economic climate. Rapid growth in the industrial countries meant expanding markets for the developing countries. It also provided a hospitable setting for the progressive liberalization of the world trading system under the aegis of GATT, the General Agreement on Tariffs and Trade.

The global economic environment worsened in the 1970s with the shock of steeply higher oil prices and the slowdown in industrial country growth after 1973. Nevertheless, the developing countries succeeded during the 1970s in maintaining a higher rate of growth in per capita GNP than that of the industrial countries themselves. This impressive performance was supported by a rapid expansion in exports of manufactured products. It is fair to say that by the beginning of the 1980s a profound transformation had taken place in the structure of Third World trade. Whereas in 1963 only 16 percent of the non-oil exports of developing countries consisted of manufactured products, by 1981 the proportion had risen to more than 50 percent.

Having made that general point, let me emphasize that the developing countries comprise an extremely heterogeneous group of nations in terms of their levels of development and the structure of their production and trade. Despite the shift in total exports toward manufactured products, most individual developing countries are still highly dependent on primary commodities for the bulk of their exports. This apparent paradox is explained by the heavy concentration of the exports of manufactures in a relatively small number of "newly industrialized countries" such as the Republic of Korea, Singapore, Brazil, Mexico, and in Hong Kong.

At the other end of the scale is a large group of low-income countries, mostly in Africa, each of whose exports are overwhelmingly concentrated in a few primary products such as coffee, cocoa, palm oil, sugar, and copper. These countries are still a long way from becoming significant exporters of manufactured products. Although their principal current trade concerns are the stability and trends of world commodity markets, their longer-term economic growth would bring about greater diversification into other agricultural products as well as into simple manufacturing.

Between the newly industrialized and the low-income countries, an increasing number of countries, such as Malaysia, Thailand, Tunisia, and Colombia, are emerging as a new wave of exporters of manufactures on a significant scale. Just as the newly industrialized countries replaced Japan in many markets for textiles, clothing and consumer electronics, so this second tier of countries is now replacing some of the original newly industrialized countries in these labor-intensive products. At the same time, a country like Korea is advancing to more complex and skill-intensive manufacturing such as transportation and engineering products. What we are witnessing, therefore, is the working out of international comparative advantage not only as between developed and developing countries, but also among the developing countries themselves.

The constant shift in the sectoral composition of a country's output and employment can be disruptive and painful. But it is the essence of long-term economic progress. It therefore needs to be accommodated, not resisted. There are three major causes: changes in consumer taste, technological change, and changes in international comparative advantage. The first two sources of change are important, but I shall focus on the third source of change as it is particularly relevant to trade relations between industrial and developing countries.

Developing countries have become conspicuously successful exporters of a number of manufactured products. And it is the concentration of penetration in particular sectors that stimulates protectionist responses in the United States and other industrial countries.

But there is the other side of the coin. At the same time that developing countries' exports of manufactures have been increasing rapidly, their imports of manufactures from the industrial countries have far exceeded their exports. In recent years, moreover, the developing countries have been a more rapidly expanding market for the manufactured products of the industrial countries than the industrial countries themselves. Even if we exclude the OPEC countries, Third World imports of manufactures from the industrial countries exceed twice the value of their exports, and this excess grew rapidly over the decade of the Seventies. Today, the developing countries take forty percent of all U.S. exports. The developing countries are therefore a more important market for American goods than all of Europe combined, including the Soviet Union.

The unprecedented growth of two-way trade in manufactured products between the developed and the developing nations reflects a historic development in the international division of labor. As the more labor-intensive and standardized activities shift to the Third World, the industrial countries are increasingly concentrating on the production of more complex goods and services embodying higher proportions of capital, technology, and skills. To the extent that this process is permitted to proceed without artificial government restrictions, all participating countries are bound to benefit in the long run.

If we accept, then, that economic growth in the developing countries is closely associated with expanding exports; and if we accept that the key to improved debt-servicing capacity for the major debtors is also export expansion, the next question is: What determines the rate of expansion?

Broadly speaking, the export prospects of developing countries depends on two sets of conditions: external and internal. The external conditions are principally the growth rate of GNP in the industrial countries and the degree to which their markets are open to the products of the developing countries. The internal conditions are the domestic policies that affect the capacity of the developing countries to respond promptly and vigorously to external market opportunities. The economic policies of the developing countries themselves are of course a major preoccupation of The World Bank, and I shall return to them shortly. But first I want to address briefly the external determinants of the developing countries' exports.

The reason why conditions in the industrial market economies are so important for the trade prospects of the developing world is simple: those economies constitute almost two-thirds of the world market for Third World exports. The recent recession amply demonstrated the link between conditions in the industrial countries and the trade of the developing countries. With the severe contraction of industrial country markets, the expansion in developing country exports declined dramatically.

Clearly, it is vital for the developing countries, and for the world economy as a whole, that the expansion now under way in the United States be paralleled in Western Europe and Japan, and that policies be adopted to sustain healthy, non-inflationary economic growth over the long term. In addition to the direct benefits to the developing countries, sustained economic growth in the industrial countries means expanding employment opportunities and a better setting for resisting new protectionist pressures.

Protectionist pressures are increasing in the United States and other industrial countries. Hardly a day goes by without a new petition for import restrictions. And even if new trade restrictions are avoided, the present conditions of access to the markets of the industrial countries are far from satisfactory.

The United States is the biggest exporter of agricultural products in the world. Nevertheless, this country does restrict imports of some agricultural products of great interest to the Third World. The main example is cane sugar, a tropical product that competes with higher-cost domestic sugar beets. Imports into the United States have been limited to 40 to 50 percent of its domestic market through the assignment of quotas to individual developing countries. Worse still, the European Community's combination of price supports and import controls have made the Community not only self-sufficient in sugar, but a net exporter, competing with developing countries in third-country markets at subsidized prices.

Cane sugar is not the only agricultural product facing severe import barriers in the major industrial countries. Fruit, vegetables, and beef are subject to restrictions of bewildering variety, including quotas, marketing orders, export restraints, and health and sanitary arrangements.

Tropical commodities such as cotton, coffee, cocoa, and rubber are generally not subject to significant import restrictions in the industrial countries. For these products the problem of market access arises when they are exported in processed form. Although the tariff on the processed product may be low, it can be extremely high as a percentage of the value added in processing. Processing is not automatically an economic use of resources in the country producing the primary product. But where it is, it should not be impeded by import barriers. Protection of the processed forms of primary products should be phased out.

I have already noted that over half the exports of non-oil developing countries consist of manufactured products. By and large, these manufactures do not encounter serious barriers in the developed countries in the form of tariffs. Duties will average less than 6.0 percent by the time the Tokyo Round reductions are completed. High tariffs are generally not the real obstacle. In many labor-intensive sectors, comparative advantage has shifted so sharply in favor of the developing countries that the only truly effective forms of protection are non-tariff measures. These usually involve some form of quantitative limitation on imports.

There are further reasons why industrial countries prefer to protect through non-tariff measures. Because most tariffs have been "bound" against increase in multilateral negotiations, raising them entails awkward legal problems. Moreover, in a world of fluctuating exchange rates the protection provided by a tariff can be quickly vitiated by the depreciation of the currency of the importing country. Finally, unlike informal types of protection such as "voluntary" export restraints, tariffs do not lend themselves well to discrimination permitting the burden of restriction to be targeted to a particular exporting country.

Non-tariff restrictions are also less visible than tariffs because, unlike published rates of duty, they are often applied through administrative action. This lack of "transparency" tends to augment the protective effect: it increases uncertainty among exporters and potential exporters, and reduces public opposition to protection within the country imposing it.

Non-tariff restrictions on manufactures have been applied most comprehensively against developing country exports in textiles and clothing. The instrument for this is the increasingly restrictive Multifibre Arrangement (MFA), under the umbrella of which detailed country-specific and commodity-specific trade limitations are negotiated. It is estimated, for example, that these restrictions have raised the costs of clothing to consumers in the United States by $2 to $4 billion. The country-specific nature of the export restraints aggravates the rigidity of the

arrangement. And this makes entry uncertain for newcomer countries, especially those of low income on the threshold of producing the restricted items competitively. Non-tariff measures are also applied against such developing country exports as footwear, radios, television sets, steel, ships and chemicals. Many of the restrictions are informal, and bilateral by nature. As such, they have been adopted without reference to the GATT criteria of market disruption and serious injury, or the obligations to consult in advance, avoid discrimination, and compensate affected countries for their losses.

I have recited this growing catalogue of protectionist measures to make an urgent point. Unless this increasing protectionism is arrested, the economic and financial problems of the developing countries can only get worse.

But we in the industrial countries will also be losers. Our exporters will find their most rapidly expanding foreign markets compressed by the slow-down in Third World growth. And our banks will find it more difficult to collect on their overseas loans. And as consumers, all of us will be deprived of the benefits of lower prices for the wide range of goods that can be produced more economically in the developing countries. In addition, we will have to pay a further price in lower economic growth.

But let me add this: an open church door is no guarantee that people will come to pray. More open world markets are an essential, but not a sufficient, condition for developing countries to expand their exports. With the same conditions of market access, some countries have achieved rapid export growth while others, at similar levels of per capita income, have experienced slow export growth or stagnation.

The key to successful export performance is the domestic policies of the developing countries themselves. High levels of protection administered through complex controls and licensing are all too common in the developing world. They insulate countries from the competitive pressures of the world trading system, resulting in structures of domestic costs and prices that effectively preclude successful exporting.

Government measures which discourage imports can simultaneously discourage exports. Tariff and import quotas on intermediate goods raise the costs of the finished product. Thus, the U.S. auto industry is disadvantaged by protection of the domestic steel industry. Protection also raises the cost of exporting by drawing resources toward industries producing for the home market and away from industries producing for export. It is therefore vital that the developing countries resist at home the protectionism they fear abroad.

In the light of my comments so far, I believe you will appreciate why The World Bank, a development institution, is so deeply concerned with these trade problems. But what, you may ask, can The World Bank, in practical terms, do about it?

The Bank's role in the trade field has basically three dimensions:

- o to provide information and analyses on the links between trade and development;
- o to promote through its operations and its policy dialogue with borrowers, the borrowers' greater integration into the international trading system;
- o and thirdly, to support other institutions' efforts to foster an open trading system.

Through its research and analysis programs, the Bank actively explores the trade and development link and scrutinizes trade policy developments. We plan to step up the effort and disseminate the fruits of our work more widely.

In our lending operations, we explicitly recognize the importance of encouraging production structures that can meet international competition. The development of exports and efficient import substitution has been promoted directly and indirectly by the Bank's project loans. Furthermore, through our sector and structural adjustment loans, the Bank supports specific programs of liberalization of tariffs, quantitative restrictions on trade and licensing requirements. The loans are designed to assist borrowing countries meet the transitional costs of adjustment, and act as a catalyst for the inflow of private capital. We work in close collaboration with the International Monetary Fund on these programs, because they are invariably accompanied by programs of stabilization with IMF support.

Of great and growing importance among the Bank's activities in this field is our policy dialogue with developing member countries on macroeconomic issues. A main objective of the dialogue is to improve domestic resource mobilization and allocation. And to that end we actively encourage measures to improve trade and industrial incentives. As I have already stressed, experience has taught us that outward-oriented strategies improve resource allocation and provide the most favorable conditions for growth.

The third dimension of the Bank's role in the trade field is to support the efforts of other institutions to foster an open trading system. And here I want to focus specifically on the GATT.

An open world trading system cannot exist without a set of rules such as those embodied in GATT. But GATT is more than a set of rules. It is also a commitment by its members to liberalize trade, a pledge that has been carried out in a succession of multilateral tariff negotiations. But, faced with serious social, financial and economic strains, many governments are finding it more and more difficult to maintain in practice the liberal trading policies to which they subscribe in principle. Nonetheless, despite the violations and circumventions of its rules and principles, the GATT system remains the major underpinning of the present international trading order, and the main institution through which trade liberalization in the 1980s can be achieved.

If we are going to arrest the damaging and self-defeating trend to protectionism, we have to look at the protective structure as a whole, rather than piecemeal. Only that way will the general and dispersed gains from liberalizing trade be recognized to be sufficiently large to ensure strong resistance to protection. And the best way to focus the attention of all trading nations on the structure as a whole is through the launching of a new round of multilateral negotiations under the aegis of the GATT.

A new multilateral negotiation would have to include all the major concerns of GATT members, and involve the active participation of members at all stages of development. There are benefits for all -- developing and industrial countries alike -- to be gained from multilateral negotiations. Such negotiations should address two concerns in particular:

- it should give special attention to trade issues of concern to developing countries;

- and a major focus on negotiations should be on liberalizing quantitative barriers to trade.

Trade negotiations take time to prepare, conduct, and implement. The longer preparations are put off, the more protectionist pressures build up and the greater the handicap to the growth of the world economy in general and the developing countries in particular. The alternative to multilateral negotiation is not the status quo, but increased protection. That is why the time to act is now.

It would be a major set-back to international economic prospects in the 1980s if the leaders at the London economic summit failed to display that essential political will that can lead to a breakthrough in the trade area. Action to roll-back protectionism and to prepare for new international trade liberalization must be sparked by a clear and unequivocal demonstration of earnest intentions at the highest political levels. The London economic summit offers an opportunity for such a demonstration that dare not be missed.

Mr. Chairman,
Ladies and Gentlemen:

The World Bank, as a development financing institution -- the largest in the world -- is a vital source of external capital and economic advice for its developing member countries. But, as a source of foreign exchange, the exports of developing countries, other than oil, are almost ten times as large as the total flows of both multilateral and bilateral assistance from the OECD countries combined. That is a measure of the importance of trade to the developing countries.

But trade and assistance are not substitutes for each other. They are complementary. Trade liberalization, enlarged flows of external finance and improved domestic economic policies in all countries are three mutually reinforcing actions. And all three actions are indispensable to the restoration of growth in the developing countries in the years ahead. That is a fact which we hope will also be fully accepted at the forthcoming economic summit.

I have come here today to plead especially for common sense and enlightened self-interest in action on the international trade front. For without that, action on the other two fronts will be in vain.

Then all of us will be the losers.

So let us opt for common sense and enlightened self-interest.

We owe it to this and to succeeding generations. In the industrial and the developing world.

Thank you.